4-25-2016

Dong Feng Fang et al Order on Cross Motions for Summary Judgment

Melvin K. Westmoreland
Fulton County Superior Court, Judge

IN THE SUPERIOR COURT OF FULTON COUNTY
STATE OF GEORGIA

DONG FENG FANG, CHUN LEI FU, MAO LIN WEI, and HONG MEI ZHOU,	)	
Plaintiffs,	)	
v.	)	Civil Action No: 2015CV261534
HEI INVESTMENTS, LLC, HOTEL EQUITIES DEVELOPMENT III, LLC, HOTEL EQUITIES GROUP, LLC, DENNIS A. MERONEY, FREDERICK W. CERRONE, FRIEDMAN, DEVER & MERLIN, LLC and SHELDON E. FRIEDMAN,	)	
Defendants.	)	
HEI INVESTMENTS, LLC, HOTEL EQUITIES DEVELOPMENT III, LLC, HOTEL EQUITIES GROUP, LLC, DENNIS A. MERONEY, FREDERICK W. CERRONE,	)	
Third Party Plaintiffs,	)	
v.	)	
HANOVER INSURANCE COMPANY,	)	
Third Party Defendant.	)	

ORDER ON CROSS-MOTIONS FOR SUMMARY JUDGMENT

Two cross-motions for summary judgment are before the Court: (1) Third Party Plaintiffs' Motion for Summary Judgment, or in the Alternative, for Partial Summary Judgment on Their Third Party Complaint Against Hanover Insurance Company; and (2) Third-Party Defendant Hanover Insurance Company's Cross-Motion for Summary Judgment as to All

Counts of the Third-Party Complaint. Having considered the briefing of all parties on both Motions and the evidence of record,[1] the Court finds as follows:

Hanover Insurance Company ("Hanover") issued a Private Company Management Liability Insurance Policy (the "Policy") with a policy period from May 15, 2014 to May 15, 2015 ("Policy Period") to Third-Party Plaintiff Hotel Equities Group, LLC ("HEG") as Named Insured. The other Third Party Plaintiffs, HEI Investments, LLC ("HEI"), Hotel Equities Development III, LLC ("HED"), Dennis A. Meroney ("Meroney"), and Frederick W. Cerrone ("Cerrone") claim to be covered by the Policy under the definitions of "Insured Entity" and "Insured Individual."[2]

Under the Policy's terms and conditions, "[Hanover] ha[s] the right and duty to defend 'Claims,' even if the allegations in such 'Claims' are groundless, false or fraudulent. [Hanover] ha[s] no duty to defend "Claims" or pay related "Defense Expenses" for "Claims" to which this insurance does not apply."

The Policy contains a Directors, Officers, and Corporate Liability Insurance Coverage Part ("D&O Coverage Part") which provides coverage to Third Party Plaintiffs for any "Wrongful Act" during the Policy Period. "Wrongful Act" is defined as:

> any actual or alleged act, error, omission, misstatement, misleading statement, neglect, breach of duty committed or attempted by:
>
> 1. An "Insured Individual" in his or her capacity as an "Insured Individual";

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[1] HEG Defendants filed a Request for Oral Hearing, but have withdrawn their Request with the consent of Hanover.

[2] Hanover, in its Answer, claims that some of the corporate entities may not meet the definition of "Subsidiary" and therefore are not "Insured Entities" but this defense to coverage was not raised in its letter to HEI denying coverage. In its June 25 Letter, discussed below, Hanover assumed that HEI and HED were subsidiaries of the Named Insured HEG, and thus "Insured Entities."

2. An "Insured Individual" while serving as a director, officer, or trustee of any "Outside Entity", if such service is at the written request or direction of the "Insured Entity"; or

3. By the "Insured Entity."

In June of 2015, Plaintiffs Fang, Fu, Wei, and Zhou filed suit against the Third Party Plaintiffs for failing to return their investment of $1.7 million in a hotel venture that never came to fruition ("Underlying Action"). According to the Complaint in the Underlying Action, in exchange for their investment, Plaintiffs executed Subscription Agreements for the purchase of Preferred Units of Membership Interest in HEI at the cost of §250,000 per Unit. According to the Subscription Agreements, the Units were being purchased in accordance with the terms of the Private Placement Memorandum dated May 19, 2014 (the "PPM").[3] Under the Subscription Agreements and PPM, Plaintiffs were supposed to receive a complete refund of their investment funds if all eleven Units in HEI were not sold by a certain date, or if other conditions were not met. Instead, Plaintiffs allege that Third-Party Plaintiffs directed their attorneys, Defendants Friedman, Dever & Merlin, LLC and Sheldon E. Friedman ("FDM Defendants"), to take the invested money out of an escrow account, and transfer the funds to another prospective investor, Black Diamond. The HEG Defendants were negotiating a separate deal with Black Diamond that conflicted with the terms of the PPM. Black Diamond neither invested its own money in the hotel venture nor returned the Plaintiffs' invested funds even though HEI never obtained eleven subscribers.

Third Party Plaintiffs notified Hanover of the Underlying Action and sought coverage and defense under the Policy. In a letter dated June 25, 2015 (the "June 25 Letter"), however,

[3] Neither the Subscription Agreements nor the PPM are attached as Exhibits to the Underlying Action's Complaint. They were, however, attached as Exhibits to Plaintiff's Motion for Partial Summary Judgment. All four Plaintiffs signed Subscription Agreements, but HEI failed to sign three of the four Subscription Agreements. None of the parties signed the PPM.

Hanover denied coverage and refused to defend HEG Defendants based on Exclusion IV.N of the D&O Coverage Part ("Exclusion N"). Exclusion N excludes from coverage:

> " 'Loss' on account of any 'Claim' made against any 'Insured' directly or indirectly based upon, arising out of, or attributable to any actual or alleged liability under a written or oral contract or agreement. However, this exclusion does not apply to your liability that would have attached in the absence of such contract or agreement."

Hanover also stated that other terms of the Policy "may serve to limit or bar coverage" and reserved its right to amend or supplement its defenses to coverage. The June 25 Letter also denied coverage to FDM Defendants, stating that they were not "Insureds" as defined by the Policy.

In response to the June 25 Letter, FDM Defendants, on behalf of HEG Defendants, sent a letter to Hanover stating why Exclusion N would not apply in this instance ("June 29 Letter").[4] Attorneys for Hanover responded with a second letter dated July 28, 2015 (the "July 28 Letter") again denying coverage and refusing to defend. In the July 28 Letter, Hanover maintained its reliance on Exclusion N, repeated its reservation of rights, and listed six other potential limitations to coverage.

Third-Party Plaintiffs filed their Third-Party Complaint in this action on August 10, 2015 seeking indemnity and defense in the Underlying Action, and raising claims for breach of contract, breach of duty and negligent claims handling, bad faith, attorney's fees, and punitive damages. In its Answer, Hanover asserting defenses to coverage including Exclusion N and the six grounds raised in the July 28 Letter, and adding at least two other grounds to deny or limit coverage, including: HEG Defendants are not "Insured Individuals" or "Insured Entities" and the claim sought restitution, disgorgement, or the return of ill-gotten gains.

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[4] The June 29 Letter also asserted that Friedman met the definition of "Insured." However, Friedman has not filed a Third-Party Complaint seeking defense or coverage under the Policy.

In its Motion for Summary Judgment, Third-Party Plaintiffs claim Hanover has waived all coverage defenses other than Exclusion N which does not apply to Plaintiffs' claims in the Underlying Action as a matter of law. Alternatively, they argue that even if the application of Exclusion N is a question of fact, Hanover breached its duty to defend because the allegations in the Underlying Action are at least arguably within the coverage provided under the Policy.

In its cross-motion, Hanover seeks dismissal of all claims against it because it contends that Exclusion N bars coverage as a matter of law and therefore it has no duty to defend or indemnify Third Party Plaintiffs. If the Court finds Hanover had a duty to provide coverage, Hanover contends it had a good faith basis to deny coverage and seek summary judgment on Third Party Plaintiffs' Counts II through V for breach of duty/negligent claims handling, bad faith, attorneys' fees, and punitive damages.

STANDARD OF REVIEW

Summary judgment shall be granted if the evidence shows that "there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law." O.C.G.A. § 9-11-56(c). In insurance coverage disputes, the insurer has the burden of proof to establish that an exclusion barring coverage applies. *Nationwide Mut. Fire Ins. Co. v. Erwin*, 240 Ga. App. 816, 818 (1999).

LAW AND ANALYSIS

The Court finds the claims raised by Plaintiffs in the Underlying Action are excluded from coverage under the Policy's Exclusion N and therefore Hanover has no duty to defend their insureds, HEG Defendants. An insurer's duty to pay and its duty to defend are separate and independent obligations. *Penn-Am. Ins. Co. v. Disabled American Veterans, Inc.*, 268 Ga. 564, 565 (1997) (citations omitted). "[W]hether an insurer has a duty to defend depends on the

language of the policy as compared with the allegations of the complaint." *Hoover v. Maxum Indem. Co.*, 291 Ga. 402, 407-08 (2012). "If the facts as alleged in the complaint even arguably bring the occurrence within the policy's coverage, the insurer has a duty to defend the action." *Id.* at 408 (citations omitted). "[T]o excuse the duty to defend the petition must unambiguously exclude coverage under the policy, and thus, the duty to defend exists if the claim potentially comes within the policy." *Landmark Am. Ins. Co. v. Khan*, 307 Ga. App. 609, 612 (2011) (citation omitted).

When interpreting insurance policies, the Court should liberally construe the policy in favor of coverage and strictly construe exclusions. *See Hartford Cas. Ins. Co. v. Smith*, 268 Ga App 224, 226 (2004); *Nationwide Mut. Fire Ins. Co. v. Erwin*, 240 Ga. App 816, 818 (1999). "The underlying facts and circumstances of the claims asserted, rather than the theory of the claims, determine whether or not the exclusion applies." *City of College Park v. Georgia Interlocal Risk Mgmt. Agency*, 313 Ga. App. 239, 243 (2011). The Court of Appeals, interpreting similar "arising out of" exclusionary provisions, focus on the "genesis" of the claims and apply a "but for" test. See, e.g., *Id.* at 245 (considering whether the subcontractor's claims against the city were in any way connected with breach of contract between city and contractor); *Continental Cas. Co. v. H.S. I. Financial Servs., Inc.*, 266 Ga. 260, 262 (1996) (considering whether claims against two law partners arose out of a third partner's culpable conduct).

Hanover argues Plaintiffs' claims are inextricably intertwined with the obligations under the Subscription Agreements and PPM, and therefore Plaintiffs' Complaint would not exist in the absence of these agreements. Thus, Hanover argues, Exclusion N applies because there would be no claims or liability but for the HEG Defendants' breach of the Subscription Agreement. This Court agrees. Plaintiffs invested money to become members of HEI. But for the

Subscription Agreement giving them a membership interest upon payment and the sale of eleven Units, Plaintiffs would not have paid into the escrow account held by FDM Defendants. The negotiations between HEG Defendants and Black Diamond would not give rise to any claim but for the terms being contrary to those in the Subscription Agreements. Exclusion N unambiguously excludes claims arising out of a written or oral contract or agreement, and none of Plaintiffs' claims would exist but for Plaintiffs' relationship with Defendants based on the Subscription Agreements and the incorporated PPM.

HEG Defendants argue that the exception to the exclusion—the exclusion does not apply to liability that would have attached in the absence of such contract—leads to a different result. First, they argue several of Plaintiffs' claims, such as unjust enrichment and money had and received, can only be brought in the absence of a contract. *See Fernandez v. WebSingularity, Inc.*, 299 Ga. App. 11, 13-14 (2009) (citations omitted) (money had and received claim "exist only where there is no actual legal contract governing the issue."); *Tidikis v. NMCR*, 274 Ga. App. 807, 811 (2005) ("A claim for unjust enrichment is not a tort, but an alternative theory of recovery if a contract claim fails."). However, the underlying facts and circumstances alleged are controlling, not the theory of the claims asserted. *See City of College Park*, 313 Ga. App. 239 (2011). In the Underlying Action's Complaint, all twenty counts rely on the same set of alleged facts: HEG Defendants had an agreement with Plaintiffs regarding their investment into HEI as memorialized in the Subscription Agreements and PPM, and Defendants disregarded that agreement by transferring money out of the escrow account and negotiating a conflicting deal with Black Diamond. As such, no liability would attach absent the Subscription Agreements and Exclusion N applies.

Second, they argue that Plaintiffs' claim for breach of fiduciary duties against HEG Defendants could, under Georgia law, arise from nature or by operation of law, not only through a contract. See O.C.G.A § 23-2-58. However, HEG Defendants do not cite a source—nature or law—which gives rise to fiduciary duties. To the contrary, the allegations in the Complaint cite to duties arising directly from the Subscription Agreements and PPM, such as the duty to refund money if eleven subscriptions are not sold and the duty to hold money in escrow. Likewise, HEG Defendants argue they have raised several tort claims, such as fraud and negligent misrepresentation that are wholly independent of the existence of a contractual relationship. Again, these counts rely on the same set of alleged facts that would not arise but for the Subscription Agreements. The Subscription Agreements are the genesis of all of Plaintiffs' claims and thus, Exclusion N excludes coverage.

And finally, HEG Defendants argue HEI was the only party to the contract among the HEG Defendants, and thus the claims against Meroney, Cerrone, HED, and HEG could not have arisen "but for" the Subscription Agreements and the PPM. But, as Hanover notes, Plaintiffs assert HEG Defendants are jointly and severally liable for breach of contract, and any duties held by Meroney, Cerrone, HED, and HEG, as agents or managers of HEI, would be as a result of the duties arising under the Subscription Agreements. Plaintiffs have simply not alleged any alternative source of a duty held by any of the HEG Defendants outside the Subscription Agreement that are relevant to their claims. Plaintiffs' asserted injuries flow from the Subscription Agreements and the breach thereof, and none of the claims would exist but for this contractual relationship between Plaintiffs and HEI.

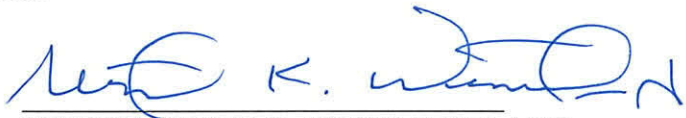
Because Exclusion N excludes the claims raised from coverage under the Policy, there is no need to determine whether Hanover waived its right to assert other coverage defenses in its

Answer that were not raised in its June 25 Letter denying coverage. Furthermore, given that coverage was excluded under Exclusion N, the denial of coverage and defense were not in bad faith.

As such, Third Party Plaintiffs' Motion for Summary Judgment, or in the Alternative, for Partial Summary Judgment on Their Third Party Complaint Against Hanover Insurance Company is **DENIED**.

Third-Party Defendant Hanover Insurance Company's Cross-Motion for Summary Judgment as to All Counts of the Third-Party Complaint is **GRANTED** and final judgment is **ENTERED** in favor of Hanover.

SO ORDERED this 25th day of April, 2016.



JUDGE MELVIN K. WESTMORELAND
Superior Court of Fulton County
Atlanta Judicial Circuit

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Attorneys for Plaintiffs	**Attorneys for Defendants**
Edwin J. Schklar Maggie M. Heim SCHKLAR & HEIM, LLC 945 East Paces Ferry Road Suite 2250, Resurgens Plaza Atlanta, Georgia 30326 Tel: (404) 888-0100 Fax: (404) 888-0001 Edwin@atlantalawfirm.net Maggie@atlantalawfirm.net Add 3PD Hanover Kevin A. Maxim THE MAXIM LAW FIRM, P.C. 1718 Peachtree St., NW, Ste. 599 Atlanta, GA 30309 kmaxim@maximlawfirm.com Ommid C. Farashahi Michael T. Shglund Adrian T. Rohrer BATESCAREY, LLP 191 North Wacker, Ste. 2400 Chicago, IL 60606 ofarashahi@batescarey.com arohrer@batescarey.com	Christine L. Mast Joseph H. Wieseman HAWKINS, PARNELL, THACKSTON & YOUNG LLP 4000 SunTrust Plaza 303 Peachtree Street Atlanta, Georgia 30308-3243 Tel: (404) 614-7400 Fax: (404) 614-7500 cmast@hptylaw.com jwieseman@hptylaw.com *For Defendants Friedman, Dever & Merlin, LLC and Sheldon E. Friedman* Stephen V. Kern C. Joseph Hoffman KITCHENS KELLEY GAYNES, P.C. 5555 Glenridge Connector Glenridge Highlands One – Suite 800 Atlanta, Georgia 30342 Tel: (404) 237-4100 Fax: (404)364-0126 skern@kkgpc.com jhoffman@kkgpc.com *For Defendants Hotel Equities Group, LLC, HEI Investments, LLC, Hotel Equities Development II I, LLC, Frederick W. Cerrone, and Dennis A. Meroney (Third Party Plaintiffs)*